A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Management Letter

Apache County

Year Ended June 30, 2003

Debra K. Davenport
Auditor General

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STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

February 7, 2005

Board of Supervisors
Apache County
P.O. Box 428
St. Johns, AZ 85936

Members of the Board:

In planning and conducting our single audit of Apache County for the year ended June 30, 2003, we performed the following as required by *Government Auditing Standards* (GAS) and Office of Management and Budget (OMB) Circular A-133:

- Considered the County's internal controls over financial reporting,
- Tested its internal controls over major federal programs, and
- Tested its compliance with laws and regulations that could have a direct and material effect on its financial statements and major federal programs.

All audit findings that are required to be reported by GAS and OMB Circular A-133 have been included in the County's Single Audit Reporting Package for the year ended June 30, 2003. In addition, our audit disclosed internal control weaknesses and instances of noncompliance with laws and regulations that do not meet the reporting criteria. Management should correct these deficiencies to ensure that it fulfills its responsibility to establish and maintain adequate internal controls and comply with laws and regulations. Our recommendations are described in the accompanying summary.

In addition, as required by Arizona Revised Statutes §41-1279.21(A)(1), we reviewed the County's financial records to evaluate whether the County used Highway User Revenue Fund monies and any other dedicated state transportation monies solely for authorized transportation purposes. However, we have requested an opinion from the Arizona Attorney General about whether certain types of county transportation department expenditures are for transportation purposes authorized by the Constitution and state laws, but have not yet received a response to our request. Once we receive the opinion, we will complete our review and report any instances of noncompliance in a separate letter.

This letter is intended solely for the information of the Apache County Board of Supervisors and is not intended to be and should not be used by anyone other than the specified party. However, this letter is a matter of public record, and its distribution is not limited.

Should you have any questions concerning its contents, please let us know.

Sincerely,

Dennis L. Mattheisen, CPA
Financial Audit Director

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The County needs to better prepare for implementation of new accounting standards

The County must issue accurate and timely financial statements to satisfy the audit requirements imposed by federal and state laws and regulations, grant contracts, and long-term debt covenants. For fiscal year 2003, the County implemented Governmental Accounting Standards Board (GASB) Statement No. 34, which prescribes a new reporting model for state and local governments. However, the County was unable to prepare accurate and timely financial statements because the County's finance department employees had not sufficiently planned and prepared to implement the new standard, including obtaining a thorough understanding of the new reporting model. As a result, it took the County over a year after fiscal year-end to prepare its financial statements in accordance with the new reporting requirements. Further, significant effort was required by the auditors to assist the County in compiling and adjusting its financial statements.

In addition, for the year ending June 30, 2007, the County will be required to report all infrastructure assets that were acquired by the County prior to July 1, 2002, on its financial statements, in accordance with GASB Statement No. 34. The identification and valuation of these infrastructure assets will be a major endeavor for the County. To date, the County has not taken any significant action to identify and value its infrastructure assets acquired prior to July 1, 2002.

To help ensure that the County's financial statements are prepared accurately and issued in a timely manner, the County should develop a comprehensive plan for implementing new accounting standards and allocate resources to:

- Research all accounting and reporting requirements to ensure that the financial statements are properly presented in accordance with authoritative pronouncements, including the reporting requirements for infrastructure assets.
- Evaluate the accounting and reporting capabilities of the County's accounting and information systems and make system and programming modifications, if practical, to account for and report the critical information, such as infrastructure assets.
- Establish processes for obtaining information not readily available from the accounting and other information systems required for financial statement presentation. Examples of such information include current year increases and decreases in long-term debt.

- Establish a process for compiling the information and preparing the financial statements and the accompanying notes, including assigned employees and completion dates.
- Have an employee who did not prepare the financial statements and the accompanying notes review them to help ensure that the amounts are accurate and properly supported and the financial statements are presented in accordance with authoritative pronouncements.
- Identify and value all infrastructure assets acquired by the County prior to July 1, 2002, so that it will be prepared to report infrastructure assets on its June 30, 2007, financial statements.

The County needs to improve controls over its information systems

The County uses computerized accounting and information systems, including the County's and County Treasurer's systems, to record and process financial transactions critical to the County's daily operations. Therefore, it is critical that the County prepare and maintain written policies and procedures for its computer operations, including a disaster recovery plan. Written policies and procedures over its computer operations serve as a reference guide and ensure accuracy and continuity in processing transactions. However, the County lacked detailed written policies and procedures over physical security of computer equipment, security controls over system access, and program changes. In addition, the County had not prepared a disaster recovery plan.

Written policies and procedures serve as a reference tool for employees seeking guidance on how to handle complex or infrequent transactions and situations. Additionally, they offer guidance for controlling daily operations. Reliance on appropriate written policies and procedures can enhance both accountability and consistency, safeguard assets and data, and help ensure that proper procedures are in place to provide for the continuity of operations and that electronic data files are not lost in the event of a disaster or other interruption. Therefore, the County should develop written policies and procedures that address security of sensitive information recorded on the system, protection of the system from physical and logical unrestricted and unauthorized access, and maintenance. Further, these policies and procedures should address approval, design, testing, documentation, and implementation of computer program changes.

In addition, the County should prepare a disaster recovery plan as soon as possible. The plan should be stored off-site and should be updated and tested at least annually. Also, the plan should include the following:

- A listing of employees assigned to disaster teams, including telephone numbers to reach them.
- Employee assignments and responsibilities.
- Written equipment backup agreements to help ensure processing continuity of critical financial transactions, including a designated physical facility, machine time availability, application processing priorities, information exchanges regarding equipment configuration and system software changes, testing procedures, and cost.
- A listing of procedures for processing critical transactions, including forms and other documents to be used.

A similar recommendation was previously provided in our Management Letter to the County dated September 9, 2003.

The Sheriff's Office should ensure payroll expenditures are proper and accurate

Salaries, wages, and related payroll costs are a major portion of the County's total expenses. Therefore, it is critical for the County and its departments to have strong payroll controls to ensure that employees are paid accurately. However, neither the County nor the Sheriff's Office established adequate internal controls to ensure that the Sheriff's Office's payroll was processed correctly. Specifically, the Sheriff's Office did not always review and approve employee time summaries, adjustments to leave balances, and compensatory time payments. As a result, Sheriff's Office employees were paid for compensatory time that they had not earned. Further, Sheriff's Office employees working in remote areas of the County were paid based on scheduled hours rather than actual hours worked.

To help strengthen controls over payroll and ensure that Sheriff's Office employees are paid accurately, the County should implement the following procedures:

- Require the Sheriff's Office to review and approve weekly time reports, time summaries, leave balance adjustments, and compensatory time payments before paying employees.
- Ensure that compensatory time payments are made only for recorded balances.
- Ensure that employees complete a time summary for each pay period that is reviewed and approved by the employee's supervisor, and retained to support the payroll. If this is not practical, employees should submit time summaries to the Payroll Department no later than the following pay period so that the County can adjust that pay period's expenses.

The Sheriff's Office should follow the County's purchasing policies and procedures

The County's purchasing policies and procedures help to promote open and fair competition among vendors and help to ensure that the County receives the best possible value for the public monies it spends. However, the Sheriff's Office did not always follow the County's purchasing policies and procedures. Specifically, the Sheriff's Office allowed employees to make purchases using their personal credit cards, which the County reimbursed. Also, for purchases costing more than $100, purchase orders were frequently prepared after the purchases were made. Further, receiving reports were not prepared to verify that goods and services were received.

To help ensure that county purchasing policies and procedures are followed, the County should provide ongoing training to all county employees with purchasing responsibilities. Also, the County should monitor departments to ensure adherence with established procedures. In addition, the Sheriff's Office should ensure that its employees adhere to the County's purchasing policies and procedures.

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Finance Director
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February 2, 2005

Debra K. Davenport, CPA
Auditor General
2910 N. 44th Street, Suite 410
Phoenix, AZ 85018

Dear Ms. Davenport:

The following is the County's response to the findings outlined in the Management Letter for the year ended June 30, 2003.

The County needs to better prepare for implementation of new accounting standards.

We concur that the county finance department was not sufficiently prepared for the implementation of the new reporting standards. Because this county does not have the resources to create separate staffing for audit purposes, it will be seeking to contract with outside services to prepare the supporting documentation and financial statements for future audits.

There is ongoing discussion concerning the method by which the County will obtain historical information about infrastructure assets acquired prior to July 1, 2002. The County does intend to be prepared with the needed information for the June 30, 2007 financial statements.

The County needs to improve controls over its information systems.

Many of the weaknesses cited for the fiscal year ending June 30, 2003 have been corrected with the implementation of new financial software in January of 2004. The system incorporates sophisticated protections against unauthorized access. Additionally, program changes are no longer made in house and assistance in the handling of complex or infrequent transactions and situations is available by contact with the customer services department of the software provider.

Currently, weekly backup tapes are stored off site at a secure location. In the event of a major breakdown, the County would seek assistance in the nature of equipment sharing from our neighboring county.

The County recognizes the need for written policies and procedures. In regards to disaster plans as well as daily operations, it is expected that such documentation will be written as staffing and time allows.

The Sheriff's Office should ensure payroll expenditures are proper and accurate.

A complete review of the findings in the County's management letter for 2003 was presented by the Office of the Auditor General to representatives of the county departments that had areas of concern. In attendance at that meeting were representatives of the Sheriff's Office. Suggested corrective action was discussed in detail.

At the time of the writing of this response, the Sheriff's Office has begun to submit retroactive corrections to attendance on letters that are now bearing signatures of authorization. Additionally, all balances of overtime were paid out on the most recent payroll.

Because of timing issues, attendance reports are still being submitted to the County without being complete as to signature authorizations. However, the Sheriff's Office has taken steps to assure that all authorizations are obtained within a reasonable time after the close of a pay period on the copies retained by the Office.

The Sheriff's Office should follow the County's purchasing policies and procedures.

The Sheriff's Office feels that it is financially advantageous to the County to allow employees to use personal credit cards for purchases for their department while an employee is in travel status. These purchases are made at large retail establishments that can offer competitive pricing, and there is no extra expense for delivery.

Currently, the documentation being submitted for reimbursement of these credit card purchases does have the required evidence of the department taking receipt of the items. Additionally, the department has begun documenting pre-authorization of these purchases. This pre-authorization serves the function of obtaining a purchase order in advance of purchase. As of this date, the Sheriff's Office has kept this documentation for their internal files. Management has requested copies to be sent to the Finance Office as back up for the reimbursements.

The County does take seriously the need to ensure that employees are trained on purchasing policies and procedures. On December 27, 2004, the county Purchasing Department distributed to all departments a binder containing the current purchasing policies and fixed asset procedures.

Additionally, when it is observed that certain procedures are not being followed and verbal reminders are not producing the desired results, the Purchasing Department distributes to all departments a memorandum addressing the subject. This same procedure is used by the Finance Department.

The County will continue to work to correct all weaknesses uncovered in the audit of the year ended June 30, 2003.

Sincerely,

Karla F. James
Finance Director